Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Developing a Unified Intercarrier	)	
Compensation Regime	)	CC Docket No. 01-92
	)	
	)	

COMMENTS OF THE NEW JERSEY DIVISION OF RATE COUNSEL

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I. INTRODUCTION

On July 24, 2006, the National Association of Regulatory Utility Commissioners' ("NARUC") Task Force on Intercarrier Compensation ("NTFIC") filed an intercarrier compensation reform plan (the "Missoula Plan") with the Federal Communications Commission ("FCC" or "Commission"). The New Jersey Division of Rate Counsel ("Rate Counsel") submits these comments in response to the public notice issued by the Commission regarding the Missoula Plan.[1]

[1] / *Comment Sought on Missoula Intercarrier Compensation Reform Plan*, Public Notice, CC Docket No. 01-92, DA 06-1510 (WCB, July 25, 2006). *See* 71 Fed. Reg. 45510. Subsequently, the Wireline Competition Bureau extended the deadline for filing comments. CC Docket No. 01-92, *Order,* DA 06-1730, released August 29, 2006.

A. INTEREST OF THE RATE COUNSEL IN THE INSTANT PROCEEDING.

The Rate Counsel is an independent New Jersey State agency that represents and protects the interests of all utility consumers, including residential, business, commercial, and industrial entities.[2] The Rate Counsel participates actively in relevant Federal and state administrative and judicial proceedings. The above-captioned proceeding is germane to the Rate Counsel's continued participation and interest in implementation of the Telecommunications Act of 1996. The New Jersey Legislature has declared that it is the policy of the State to provide diversity in the supply of telecommunications services, and it has found that competition will "promote efficiency, reduce regulatory delay, and foster productivity and innovation" and "produce a wider selection of services at competitive market-based prices." The resolution of the complex economic and policy issues that this proceeding embraces directly affects the structure of telecommunications markets, and the prices that consumers pay for basic telecommunications service.

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[2] / Effective July 1, 2006, the New Jersey Division of Ratepayer Advocate is now the New Jersey Division of Rate Counsel. The Rate Counsel, formerly known as the New Jersey Ratepayer Advocate, is a Division within the Department of the Public Advocate. The Department of the Public Advocate is a government agency that gives a voice to New Jerseyans who often lack adequate representation in our political system. The Department of the Public Advocate was originally established in 1974, but it was abolished by the New Jersey State Legislature and New Jersey Governor Whitman in 1994. The Division of the Ratepayer Advocate was established in 1994 through enactment of Governor Christine Todd Whitman's Reorganization Plan. The mission of the Ratepayer Advocate is to make sure that all classes of utility consumers receive safe, adequate and proper utility service at affordable rates that are just and nondiscriminatory. In addition, the Ratepayer Advocate works to insure that all consumers are knowledgeable about the choices they have in the emerging age of utility competition. The Department of the Public Advocate was reconstituted as a principal executive department of the State on January 17, 2006, pursuant to the Public Advocate Restoration Act of 2005, P.L. 2005, c. 155 (*N.J.S.A*. §§ 52:27EE-1 et seq.). The Department is authorized by statute to "represent the public interest in such administrative and court proceedings . . . as the Public Advocate deems shall best serve the public interest," *N.J.S.A.* § 52:"27EE-57, *i.e.*, an "interest or right arising from the Constitution, decisions of court, common law or other laws of the United States or of this State inhering in the citizens of this State or in a broad class of such citizens." N.J.S.A.§52:27EE-12, and the office of the Rate Counsel, formerly known as the Ratepayer Advocate, became a division therein to continue its mission of protecting New Jersey ratepayers.

In this proceeding, the Commission seeks to replace the various existing intercarrier compensation regimes "with a unified arrangement that accommodates competition and new technologies."[3] Among the FCC's goals in this proceeding are economic efficiency, preservation of universal service, competitive neutrality, technological neutrality, and compatibility of any proposal with the FCC's legal authority to implement such a plan. Ultimately, the resolution of this complex proceeding will affect consumers' prices and the competitive landscape. As the Rate Counsel stated in initial comments submitted on May 23, 2005, the Rate Counsel "particularly urges the Commission to consider the impact of new intercarrier compensation schemes on residential and small business consumers, rates for basic services, rural consumers, and low-volume users."[4]

B. SCOPE OF THE PUBLIC NOTICE

The Missoula Plan, which AT&T Inc. ("AT&T"), BellSouth Corp. ("BellSouth"), Cingular Wireless ("Cingular"), Global Crossing, Level 3 Communications, and 336 members of the Rural Alliance support,[5] purports to unify "intercarrier charges for the majority of lines" and to move "all intercarrier rates charged for all traffic closer together."[6] The NARUC Task Force on Intercarrier Compensation led the industry

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3 / *In the Matter of Developing a Unified Intercarrier Compensation Regime*, FCC CC Docket No. 01-92, *Further Notice of Proposed Rulemaking*, Released March 3, 2005 ("Intercarrier Compensation FNPRM" or FNPRM"), at para. 1.

4 / Initial Comments of the Rate Counsel, May 23, 2005, at 3 ("Rate Counsel Initial Comments"). The Rate Counsel also submitted reply comments on July 20, 2005 ("Rate Counsel Reply Comments").

5 / NARUC Task Force on Intercarrier Compensation, *The Missoula Plan for Intercarrier Compensation Plan, July 18, 2006*, filed as a written *ex parte* in CC Docket No. 01-92, July 24, 2006 ("Missoula Plan"), at Appendix C.

6 / Missoula Plan, at 1.

negotiations that led to the Missoula Plan, but neither the task force members nor NARUC have taken positions on the proposal.[7] The Public Notice seeks comment on the Missoula Plan.

C. SUMMARY OF COMMENTS

The Commission should reject the ill-conceived Missoula Plan for several reasons, foremost among them that:

- Despite incumbent local exchange carriers' benefiting from billions of dollars in merger synergies, mis-assigned common network costs, and excessive returns on special access services, the Missoula Plan would burden consumers with an increase to basic local exchange service.
- The Missoula Plan's complexities and details obfuscate the fact that the plan would improperly guarantee incumbent carriers an historic stream of revenues that bears no relationship to (1) the changing pattern of consumers' use of the telecommunications network; (2) declining costs in the telecommunications industry; and (3) the incentives for cost-cutting and efficiency that competition should yield.
- The Missoula Plan distracts regulators, consumers, and industry members from critically important and integrally related efforts to re-initialize excessive special access rates and to correct separations processes which presently result

[7]/ Letter from Tony Clark, Commissioner and Chair, NARUC Committee on Telecommunications, Ray Baum, Commissioner and Chair, Task Force on Intercarrier Compensation, Larry Landis, Commissioner and Vice-Chair, Task Force on Intercarrier Compensation to Federal Communications Commission Chairman Kevin Martin, Re: Notice of written ex parte presentation in CC Docket 01-92, July 24, 2006 ("NARUC Letter").

in the improper cross-subsidization of unregulated ILEC services with revenues from regulated services.

- The Missoula Plan would harm the working poor (who do not qualify for Lifeline programs), low-income customers who are eligible for but do not participate in Lifeline programs, consumers residing in rural communities, and low-volume consumers. These customers are precisely the consumers who are least likely to have access to emerging competitive alternatives.
- The Missoula Plan would improperly usurp states' rate-making authority.

The Commission should afford the Missoula Plan minimal weight and instead allocate its resources and expertise toward correcting the flaws in the separations process and establishing just and reasonable rates for interstate special access. The Rate Counsel supports fully the Commission's objective to unify the disparate intercarrier compensation schemes, but the Missoula Plan does not merit consideration.

II. ANALYSIS OF PLAN

A. MISSOULA PLAN

The Missoula Plan proposes to lower switched access revenues (which are presently about $8.9 billion) by almost $6 billion.[8] The Plan would recover these revenues by increasing the revenues derived from the subscriber line charge ("SLC") by $4.7 billion;[9] implementing a new Restructure Mechanism, estimated to generate

8 / Missoula Plan, Appendix D, at 100.

9 / *Id.*

approximately $1.5 billion;[10] increasing the High Cost Fund;[11] and establishing an "Early Adopter Fund" in the amount of $0.2 billion.[12]

The Missoula Plan and its various attachments demonstrate clearly that industry members would benefit through lower access charges, higher fixed SLCs, and various "revenue recovery" mechanisms. By contrast, consumers' fixed monthly charges would indisputably increase. Any consumer benefits are speculative and unlikely because the increasingly concentrated industry lacks any economic incentive to flow through lower access charges. Furthermore, the Missoula Plan exaggerates the level of revenue support required to implement the change.

The Missoula Plan classifies carriers among three tracks, which determines the specific rate levels for intercarrier compensation and subscriber line charges. Track 1 carriers include the lines of all Bell operating companies, CLECs, interexchange carriers, and CMRS carriers. Track 1 encompasses 146.2 million incumbent local exchange carrier ("ILEC") loops. Track 2 includes the lines of most mid-sized rural carriers and encompasses 12.5 million ILEC loops. Track 3 includes the lines of the smallest, and rate-of-return-regulated carriers and encompasses 7.3 million ILEC loops.[13] Track 1 covers 92 ILEC study areas; Track 2 covers 158 ILEC study areas; and Track 3 covers 1,185 study areas.[14] Table 1 summarizes the proposed "tracks."

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[10] / Missoula Plan, Executive Summary, at 13, Appendix D, at 99.

[11] / Missoula Plan, Executive Summary, at 13.

[12] / *Id.*, fn 12.

[13] / Missoula Plan, at 5; Executive Summary, at 1.

[14] / Missoula Plan, at 5.

Table 1
Missoula Plan "Tracks"

Track	*Carriers Included*	*Number of Loops Included*	*Number of Study Areas Included*
Track 1	RBOCs and other non-rural carriers (e.g. CLECS, IXCs and CMRS carriers)	146.2 million	92
Track 2	Most mid-sized rural carriers	12.5 million	158
Track 3	Smallest, rate-of-return rural carriers	7.3 million	1,185
Source: Missoula Plan, at 5; Missoula Plan, Executive Summary, at 1.			

The procedure that led to the development of the Missoula Plan was flawed because it failed to include consumer representatives.

The Rate Counsel recognizes that NARUC and industry representatives expended significant effort and time to develop a consensus on a proposal to reform intercarrier compensation.[15] Unfortunately, the process was flawed because it failed to include representatives of consumer advocates in the deliberations. The absence of consumer participation in the process is evident in the "consensus" document: under the Missoula Plan, consumers would bear a disproportionate share of the cost and risk of reform, and industry would be guaranteed a steady stream of revenues. The Rate Counsel urges the Commission to reject the Missoula Plan not only because it is based on a process that excluded consumer input, but more importantly because the end result penalizes all consumers. Furthermore, those in rural areas and those with low telecommunications usage would be harmed the most.

[15] / NARUC created the Task Force on Intercarrier Compensation in April, 2003. NARUC Letter, at 1.

The Missoula Plan would harm precisely those consumers with the lowest elasticity of demand.

The Missoula Plan includes specific, planned rate increases in fixed charges for consumers yet, as is discussed in more detail below, offers only promises of rate reductions for usage. The monthly SLC rates for most consumers would increase to more than $10.00 (ten dollars in the fourth year of the plan, with a provision for inflation-based increases after that). In New Jersey, the SLC for primary residential and single line business is $6.50, and the SLC for non-primary residential line and multiline business $6.51.[16]

The proponents have failed to demonstrate the need to increase the SLC by the rate of inflation. Historically, the telecommunications industry has enjoyed productivity gains that more than offset inflation.

Tables 2, 3, and 4 summarize the proposed SLC caps for Track 1, Track 2, and Track 3 customers, respectively.

Table 2
Proposed SLC Caps for Track 1 Carriers

Step	*Primary Residential/Single Line Business*	*Non-primary residential*	*Multiline business*
Present cap	$6.50	$6.50	$9.20
1	$7.25	$7.25	$9.20
2	$8.00	$8.00	$9.20
3	$9.00	$9.00	$9.20
4	$10.00	$10.00	$10.00
SLC Cap	$10.00	$10.00	$10.00
Step 5 and Beyond: SLC cap rises with inflation			
Source: Missoula Plan, at 20.			

[16] / Verizon Telephone Companies, Tariff F.C.C. No. 1, 14th Revised page 4-12 and 14th Revised Page 4-13, effective September 30, 2006.

Table 3
Proposed SLC Caps for Track 2 Carriers

Step	*Primary Residential/Single Line Business*	*Non-primary residential*	*Multiline business*
Present cap	$6.50	$6.50	$9.20
1	$7.25	$7.25	$9.20
2	$8.00	$8.00	$9.20
3	$8.75	$8.75	$10.00
No increase for inflation			
Source: Missoula Plan, at 20-21.			

Table 4
Proposed SLC Caps for Track 3 Carriers

Step	*Primary Residential/Single Line Business*	*Non-primary residential*	*Multiline business*
Present cap	$6.50	$6.50	$9.20
1	$7.25	$7.25	$9.20
2	$8.00	$8.00	$9.20
3	$8.75	$8.75	$9.20
No increase for inflation			
Source: Missoula Plan, at 20-21.			

The Missoula Plan proponents' assertion that "all low-income consumers are fully protected under the Missoula Plan,"[17] is misleading. The Missoula Plan would waive SLC increases for Lifeline users,[18] but would not protect the vast majority of the nation's low-income households. First, the proposed increase in the subscriber line charge would harm low-income households that are eligible for Lifeline but who do not participate in the program. Despite state and federal efforts to increase Lifeline participation, significant numbers of eligible households do not participate in the program, and,

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[17] / Missoula Plan, Exhibit 1, "The Missoula Plan Will Result in Lower Telephone Bills," at 1.

[18] / *Id.*

therefore, would be harmed by the Missoula Plan's proposed SLC increase. For example, according to FCC's latest *Trends in Telephone Service* report, written using data compiled as of April 2005, there were 118,299 Lifeline participants in 2004, in New Jersey,[19] far fewer than the approximate 400,000 to 500,000 customers that the New Jersey Board of Public Utilities estimates are eligible for the program.[20]

Furthermore, the proposed SLC increase would also harm the many households throughout the county that do not qualify for the Lifeline program, but that have severely limited household budgets. By way of illustration, Figure 1 shows the income distribution for New Jersey.

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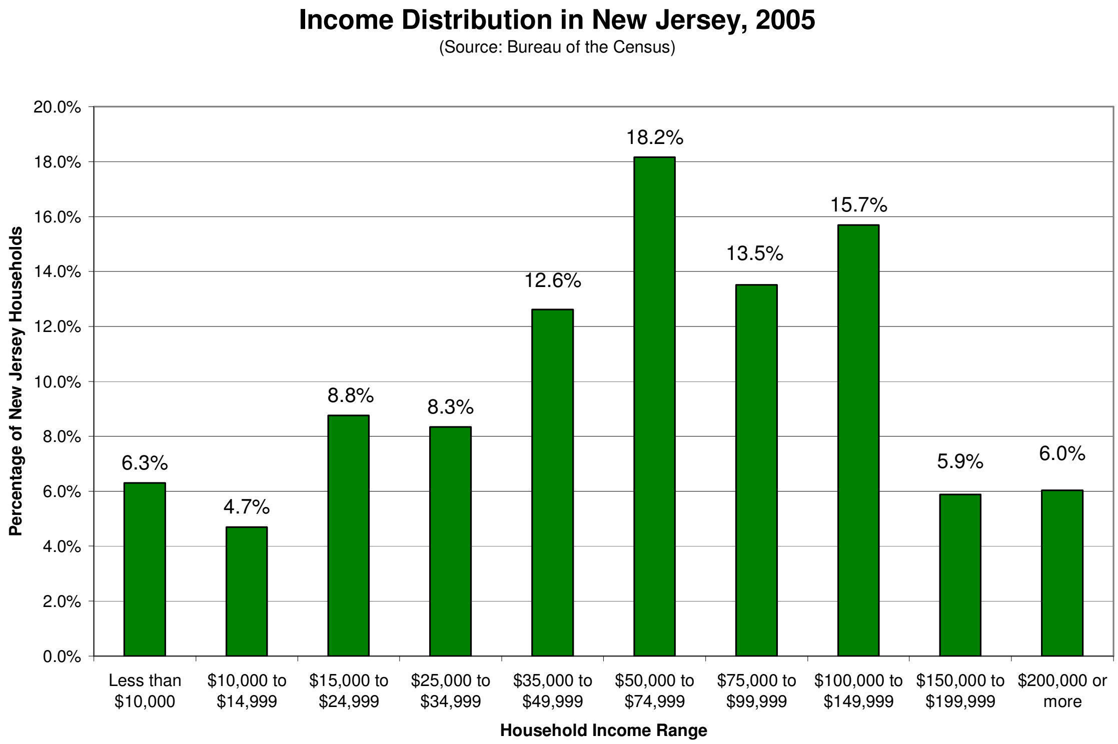
[19] / *Trends in Telephone Service*, Industry Analysis and Technology Division, Wireline Competition Bureau, Tables Compiled as of April 2005, Table 19.9.

[20] / *In the Matter of the Application of Verizon New Jersey, Inc. For (i) Approval of a New Plan for an Alternative Form of Regulation and (ii) to Reclassify Multi-Line Regulated Business Services as Competitive Services, and Compliance Filing,* New Jersey Board of Public Utilities Docket No. TO)1020095, *Decision and Order*, August 19, 2003, at 29, 31.

Figure 1[21]



Moreover, the Missoula Plan's proposal to increase fixed subscriber charges would jeopardize the achievement of universal service at a time when subscribership is declining. The most recently available statistics, released by the Commission this month, indicate that nationwide telephone subscribership has declined over the past three years from a high of 95.5% in March of 2003 to a low of 92.8% in March of 2006.[22] In New Jersey, the percentage of households with a telephone fell from 96.6% in July of 2003 to 93.4% in March of 2006.[23] This decline cannot be attributed to consumers "cutting the

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[21] / Bureau of the Census.

[22]/ Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, *Telephone Subscribership in the United States*, data through March 2006, released October 2006 ("FCC Subscribership Report"), at Table 1.

[23] / *Id*., at Table 2 and Table 3.

cord" and opting to use wireless phones and/or alternative technologies for telephone service as opposed to wireline connections: the FCC study counts such households as telephone subscribers.[24] As of March 2005, the percentage of low-income households with telephone service was 86.4%, significantly less than the national average penetration (92.6%) and even further below the penetration for the top income bracket (96.1%).[25]

The Commission should reject the Missoula Plan because it would enrich the industry and raise consumer charges.

The proponents of the Missoula Plan contend that their proposed reform of intercarrier compensation would yield consumer benefits.[26] The Missoula Plan filing also includes an analysis of economic benefits that are anticipated to flow to consumers and to society as a result of the proposed reform.[27] However, the foundation of the analysis of economic benefits is tenuous at best because the proponents do not provide any evidence

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24/ *Id.*, at footnote 3, stating: "The questions are intended to be neutral as to whether the household has wireline or wireless phones." The question asked in the Current Population Survey, from which the FCC data are derived, is: "Does this house, apartment, or mobile home have telephone service from which you can both make and receive calls? Please include cell phones, regular phones, and any other type of telephone." *Id.*, at 2.

25 / Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, *Telephone Penetration by Income by State*, data through March 2005, released May 2006, at Table 4. In the FCC's report low-income households are defined as those with incomes less than $10,000 in 1984 dollars (equivalent to $18,840 in current dollars). The top income bracket is defined as those with incomes of $40,000 of more in 1984 dollars (equivalent to $75,360 in current dollars). *Id.* This income disparity is evidenced in the latest FCC Subscribership Report as well. For example, just 89.7% of households with income of $12,500 to $14,999 had telephones while 97.3% of households with income between $100,000 and $149,999 had access to telephones. FCC Subscribership Report, at Table 4. The FCC Subscribership Report income data is in nominal dollars (*i.e.* not adjusted for inflation). *Id.*, at 5.

26 / *See e.g.*, Missoula Plan, Executive Summary at 1, which states, among other things, "[t]he main winners are consumers."

27 / Exhibit 2, "Economic Benefits from Missoula Plan Reform of Intercarrier Compensation," Richard N. Clarke, Thomas J. Makarewicz, AT&T, July 18, 2006 ("Economic Benefits Paper").

to substantiate the fundamental proposition that carriers will lower long distance rates as a result of the Missoula Plan's proposed reduction in access charges.

The analysis describes among other things, "the gross increase in consumer surplus (*i.e.*, the welfare gain consumers enjoy from reduced long distance prices enabled by lower access charges)."[28] The Rate Counsel does not dispute, as an economic matter, the proposition that consumer surplus could result from rate reductions, particularly where excessive rates depress demand. However, that surplus depends critically on the *industry actually lowering prices.* The Commission should afford little weight to the proponents' analysis of economic benefits because (based on the increasing concentration in today's telecommunications industry) the prospect of carriers *voluntarily* lowering rates is negligible.[29] Carriers can easily "bury" toll rate increases in the prices that they charge for bundled offerings, and use those rate increases to subsidize their video and Internet access offerings. The Rate Counsel urges the Commission to reject the implicit proposition that the Missoula Plan would lead to lower rates for consumers.

Furthermore, as stated in the proponents' analysis, even if carriers were to lower long distance rates, the benefits are limited. First, only those customers who use long distance services frequently stand to benefit. Second, if carriers actually reduce rates, they likely would target any reductions to the prices for high-volume, bundled packages. Theoretically, if rates for bundled packages decline as a result of the access charge reductions, the rate decline could spur more customers to subscribe to bundled packages, and thus to increased usage of the public switched network. Offsetting this potential

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[28] / *Economic Benefits Paper*, at 1.

[29] / *See* discussion below regarding Bell dominance of the bundled and long distance market.

benefit (that is, increased usage and corresponding benefit from the public switched network), however, are the following factors: (1) because the cable-telco duopoly does not provide effective competition, it is unlikely that carriers would actually *lower* their bundled package prices and (2) by targeting rate reductions to high volume users, carriers would increase the effective burden of intercarrier compensation reform on low-use customers. As the proponents acknowledge:

> Certain customers may benefit more than others from the Missoula plan. As discussed, a customer benefits when his gain from lower long distance prices more than offsets his end user charge increase. Thus, the more long distance a customer uses, the greater that customer benefits.[30]

There is no guarantee, nor are there sufficient competitive pressures to ensure, that long distance prices will actually decline. Furthermore, those customers with low usage would face unambiguous rate *increases.*

Carriers should not receive new revenue streams until the Commission assesses the impact of special access overearnings, mis-applied separations rules, and substantial merger synergies.

The Missoula Plan is backward-looking because its primary purpose appears to be to guarantee ILECs "the revenues historically earned through higher intercarrier charges." The Missoula Plan is a blueprint for historic preservation of carriers' monopoly revenue streams.

New guaranteed revenues for carriers:

Restructure Mechanism: $1.5 billion.[31]

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[30] / *Economic Benefits Paper*, at 4.

[31] / Missoula Plan, Executive Summary, at 13; Appendix D, at 99.

Increase in SLC revenues: $4.7 billion.[32]

High Cost Modifications: $300 million.[33]

Early Adopter Fund: $200 million.[34]

Furthermore, in a footnote, the Plan's proponents warn that "if a State does not adopt the Plan, carriers in that State may have to seek higher payments from end-user customers, given the increasing erosion of intercarrier revenues."[35] The Plan is based on an implicit expectation of entitlement by carriers to a set revenue stream. In the face of purported competition, which should drive rates closer to cost and which should spur innovation and further cost reductions in production of telecommunications services, *one would expect revenues to decline.* Instead, the Missoula Plan seeks to memorialize an historic revenue stream in the face of purported competition.

A fundamental deficiency in the Missoula Plan is the implicit expectation that carriers are entitled to receive a particular stream of revenues. There are numerous reasons that incumbent carriers should not be entitled to revenue recovery. Industry consolidation has not only thwarted competition, but also has yielded billions of dollars in merger synergies for incumbent carriers. The Missoula Plan fails to incorporate the significant revenue windfall flowing from recent mergers:

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[32] / Missoula Plan, Appendix D, at 100.

[33] / Missoula Plan, Executive Summary, at 13, fn 12.

[34] / *Id.*

[35] / "The Missoula Plan: Policy and Legal Overview," at 8.

Table 5[36]
Net Present Value of Merger Synergies

	Synergy NPV (in billions)	*Date merger consummated*
Verizon/MCI	$7	01/06/2006
SBC/AT&T	$18	11/18/2005
AT&T/BellSouth	$18	pending
Total Net Present Value of Merger Synergies	$43	

Flawed separations: As is discussed in more detail below, consumers are subsidizing more than $15 billion in mis-assigned and mis-allocated costs in common network facilities that Bells are using to offer unregulated services.

Special access overearnings: In WC Docket No. 05-25, the FCC has recognized the extreme rates of return that Bell operating companies are earning, which provides further evidence that the FCC should not presume the overhaul of the intercarrier compensation systems will prevent ILECs from earning a reasonable rate of return. In its *Order and NPRM* in WC Docket No. 05-25, the FCC notes "the BOCs have earned special access accounting rates of return substantially in excess of the prescribed 11.25

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[36] / *In the Matter of Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, WC Docket No. 05-75, Application for Transfer of Control, filed March 11, 2005, Appendix 1: Public Interest Statement, at 3. The merger of SBC and AT&T was originally projected to produce $15 billion in synergies. *In the Matter of Transfer of Control Filed by SBC Communications Inc. and AT&T Corp.*, WC Docket No. 05-65, Description of the Transaction, Public Interest Showing, and Related Demonstrations, filed February 21, 2005, at 44. However, the synergy estimate was revised from $15 billion to $18 billion earlier this year. Declaration of Kahan (AT&T) in WC Docket No. 06-74, at 19, citing Analyst Meeting Presentation, January 31, 2006, at 51; AT&T Investor Update: 1Q06 Earnings Conference Call, April 25, 2006. *In the Matter of AT&T Inc. and BellSouth Corporation Applications for Approval of Transfer of Control*, WC Docket No. 06-74, Application for Consent of Transfer of Control, filed March 31, 2006, Attachment 1: Description of Transaction, Public Interest Showing and Related Demonstration, at 4. SBC closed its acquisition of AT&T on November 18, 2005. "New AT&T Launches," AT&T News Release, November 18, 2005. Verizon closed its acquisition of MCI on January 6, 2006. See, http://investor.verizon.com/profile/history/history_001.aspx. Both transactions are presently under review by the federal district court. United States of America v. SBC Communications Inc. *et al*, 1:05-cv-2102, United States of America v. Verizon Communications Inc. et al, 1:05-cv-2103. The New Jersey Rate Counsel is participating as an *amicus curiae.*

rate of return that applies to rate of return LECs. The BOCs' collective average special access accounting rates of return over the last six years (1998 - 2003) have been 18, 23, 28, 38, 40, and 44 percent, respectively." [37]

Consumers would bear all the risk of competition and intercarrier compensation reform.

One of the documents submitted with the Missoula Plan states that "although the Plan allows limited increases to subscriber line charges, deep reductions in intercarrier charges will generate significant reductions in many other end user rates."[38] The Rate Counsel urges the Commission to afford this speculation no weight. There is absolutely no guarantee that the "deep reductions in intercarrier charges" will translate into consumer savings. Based on the lack of competition in the long-distance market and indeed in most telecommunications markets, carriers have no economic incentive to share their savings in access charges. Instead, carriers have demonstrated their willingness and ability to *increase* long distance rates.[39] The Missoula Plan proponents apparently expect

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[37] / *In the Matter of Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, FCC WC Docket No. 05-25; RM-10593, *Order and Notice of Proposed Rulemaking*, Released January 31, 2005, at para. 35.

[38] / "The Missoula Plan: Policy and Legal Overview," at 2.

[39] / After announcing its acquisition of MCI, and while the merger was being reviewed by the Commission, Verizon imposed a $2 increase in its long distance portion of the Freedom for Business month-to-month calling plans. The increase could be avoided by signing on for a term commitment. *See*, *In the Matter of Verizon Communications, Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, Federal Communications Commission WC Docket No. 05-75, sponsored declaration of Susan M. Baldwin and Sarah M. Bosley on behalf of the New Jersey Division of the Ratepayer Advocate, filed May 9, 2005, citing Verizon's website at http://www22.verizon.com/Business/fyb/Packages/Packages/Verizon%20Freedom%20For%20Business/222/222_NJ and stating "Verizon's ability to raise rates for its long distance service suggests that competition is lacking the in the bundled services market." A printed copy of Verizon's notice regarding the increase on its website is attached to the declaration as Exhibit SMB-6.

consumers to be satisfied with speculative savings while carriers would rely on guaranteed revenue recovery.

The Commission should reject the Missoula Plan because it is fundamentally unfair. There is no guarantee and indeed it is improbable that carriers will flow through access charge reductions. The Bells dominate the long distance market. The Bells' entry into the long distance market has been, and continues to be, enormously successful. The Track 1 carriers' dominance of the long distance market undermines any likelihood of consumers benefiting from the flow-through of reduced access charges.[40] According to annual and quarterly financial reports:

- BellSouth added 118,000 long distance subscribers in the third quarter of 2006 and now serves 7.6 million long distance customers (representing approximately 63% of its mass-market customer base).[41] The number of long distance lines served by BellSouth increase almost 9% between the third quarter 2005 and third quarter 2006.[42]
- AT&T's base of long distance lines grew from approximately 14.4 million at the end of 2003 to 23.5 million at the end of 2005, an increase of 63%[43] and

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[40] / *See*, *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint,* CC Docket No. 80-286, Affidavit of Susan M. Baldwin, on behalf of the New Jersey Division of Rate Counsel and the National Association of State Utility Consumer Advocates, August 22, 2006 ("Baldwin Separations Affidavit"), at para. 136 and Appendix E for more discussion and analysis of Bells' dominance of the long-distance market.

[41] / BellSouth Corporation, *BLS Investor News*, October 24, 2006, at 3.

[42] / BellSouth Corporation, Quarterly Financial View 1Q04 – 3Q06, available at http://phx.corporate-ir.net/phoenix.zhtml?c=95539&p=irol-IRHome.

[43]/ *AT&T 2005 Annual Report*, May 5, 2006, at page 25. End of year 2005 data for AT&T are used because the latest quarterly results include data for lines losses of legacy AT&T which made a decision to discontinue marketing its mass market services.

sixty-eight percent of AT&T's retail customers subscribed to a bundle as of year-end 2005.[44]

- Qwest served more than 4.8 million long distance customers at the end of the second quarter 2006 compared to just over 4 million at the end of the second quarter 2004, a 19% increase[45] and bundle penetration reached 54% as of June 30, 2006.[46]
- Verizon reported a 40% increase in mass-market bundle subscriptions between June 30, 2005 and June 30, 2006 and now provides 6.9 million mass market customers with its Freedom packages[47] and the total number of long distance lines served by Verizon increased 15.5% from December 31, 2003 to December 31, 2004 and increased 5.7% from December 31, 2004 to December 31, 2005.[48]

In contrast with the vague possibility of long distance rate reductions, the Missoula Plan includes certain consumer rate increases and guaranteed carrier revenue streams. The Missoula Plan would increase subscriber line charge and also would create a new "Restructure Mechanism," which the plan's proponents describe as "designed

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44 / AT&T *Investor Briefing*, 4Q 2005, January 26, 2006, page 5.

45 / Qwest Communications, "Historic Quarterly Results – 1Q04 through 2Q06", available at http://phx.corporate-ir.net/phoenix.zhtml?c=119535&p=irol-reportsAnnual (accessed August 9, 2006).

46 / Qwest Communications News Release, "Qwest Reports Higher Sequential Net Income, Continued Margin Expansion, and Strong Free Cash Flow," August 1, 2006.

47 / Verizon Communications, *Investor Quarterly 2Q 2006*, August 1, 2006, at 6.

48 / Verizon Communications, 2005 Annual Report, at 16. As of the end of the first quarter 2005, 58% of Verizon residential customers subscribed to local and long distance and/or DSL service. Verizon Communications *Investor Quarterly 1Q 2005*, April 27, 2005, at 3.

specifically to replace switched carrier-to-carrier revenues lost by carriers participating in the Plan and not otherwise compensated for that loss through end-user charges."[49]

The Missoula Plan asserts that "creating greater national consistency in intercarrier compensation rates will *benefit* consumers."[50] The promise of benefits rings hollow, particularly when contrasted with the guaranteed revenue recovery mechanism that the Missoula Plan proponents advocate.

The Missoula Plan filing lacks any cost data.

The Missoula Plan proponents failed to submit cost data that would enable the Commission and consumers to compare the relationship between the proposed rate levels for intercarrier compensation and the cost of originating and terminating traffic. Consistent with its initial and reply comments in this proceeding, the Rate Counsel supports movement toward uniform, cost-based rates.[51] In order to assess whether any particular proposal achieves the objective of economically efficient pricing signals, up-to-date cost studies with comprehensive supporting documentation are necessary.

Similarly, the Missoula Plan proponents have failed to demonstrate that an *increase* in the SLC is economically efficient or fair. In CC Docket No. 80-286, the Rate Counsel submitted comprehensive analyses demonstrating the urgent need to re-initialize rates for regulated services. Among other things the Rate Counsel stated:

> [C]onsumers of intrastate regulated services are bearing unfairly the cost of billions of dollars of carriers' investment in plant and related expenses

[49] / Missoula Plan, Executive Summary, at 1.

[50] / Missoula Plan, Attachment A, "Legal Analysis of Track 1 and 2 Carriers Concerning Measures to Ensure State Compliance with Rate Provisions for Tracks 1 and 2," at 8 (emphasis in original).

[51] / Rate Counsel Reply Comments, at 2-5, 10, 16, 19.

> that should be assigned and allocated to unregulated lines of business and interstate services. Numerous factors create a gross mismatch between carriers' accounting of their revenues and costs including: the Bells' pursuit of unregulated lines of business; the Bells' increasing sales of long distance and bundled services which mingle intrastate, interstate, regulated, and unregulated products; the Commission's declaration that wireline broadband services are information services; and the increase in VoIP and ISP-bound traffic that the Commission has classified as interstate. These seismic changes justify a close examination of costs and rates by federal and state regulators.[52]

The Commission should reject outright any proposal that would increase the SLC before carriers have demonstrated that they have assigned and allocated a proper portion of the cost and expense of common plant to unregulated services.

The Missoula Plan's "Step 2" component that would allow carriers to petition the Commission to preempt State authority is unlawful.

The Missoula Plan "allows" carriers to petition the Commission to preempt State authority over Track 1 and Track 2 carriers' intrastate originating access rates.[53] The Rate Counsel opposes the recommended preemption of state authority over intrastate rates as a matter of policy, and, furthermore, disagrees with the plan's proponents that such preemption could be considered lawful The Missoula Plan includes a document entitled, "The Missoula Plan: Policy and Legal Overview," which attempts, but fails, to provide policy and legal justification of the plan's components.

The Rate Counsel reiterates its position, stated in its initial comments in this proceeding: "States are in the best position to assess the affordability of basic service and to examine carriers' need, if any, to adjust rates as a result of modified intercarrier

[52] / Baldwin Separations Affidavit, at para. 12.

[53] / Missoula Plan, Executive Summary, at 2.

compensation regimes. States, similarly, have jurisdiction over intrastate access charges and also are in the best position to design and implement plans for revising these rates."[54] There is absolutely no policy or legal basis for the Commission to interfere with state rate-making, particularly in light of the fact that the Commission's delay in correcting carriers' accounting treatment of common plant used for services such as DSL results in overstated intrastate revenue requirements and rates.

B. RELATIONSHIP TO OTHER PENDING PROCEEDINGS

The Commission should correct failures in the separations and special access regimes before reforming intercarrier compensation.

In the name of simplifying intercarrier compensation systems, the Missoula Plan would protect carriers from any possible revenue erosion, and likely increase their revenue streams. The Rate Counsel does not oppose reasonable Commission measures to implement a unified intercarrier compensation system, but achievement of that goal should not obscure other, more important goals such as those of just and reasonable rates and universal service.

Consumers of intrastate regulated services are subsidizing more than $15 billion of carriers' entry into new lines of business and interstate services as a result of carriers' failure to assign and allocate common plant properly.[55] The Plan's proponents bemoan the possibility that states' individual rate setting could complicate efforts to unify intercarrier compensation, stating:

[54] / Rate Counsel Initial Comments, at 9.

[55] / Baldwin Separations Affidavit, at 69.

> The Commission cannot implement a comprehensive and unified solution if the States continue to prescribe intrastate access charges that vary materially from their interstate counterparts. … Federal rate caps are therefore necessary to ensure that State regulation does not thwart the Commission's goals: namely effective reform of intercarrier compensation, preservation of universal service, and promotion of competition and deregulation.[56]

In sharp contrast with the concern expressed by the Missoula Plan proponents (that States are jeopardizing the achievement of federal telecommunications goals), the Commission's delay in clarifying separations rules thwarts the States' goals of ensuring just and reasonable rates. As was stated on behalf of the Rate Counsel, in the Commission's pending investigation of separations:

- Unless and until state regulators exercise their existing rate-making authority and the Commission clarifies its cost accounting rules, consumers of intrastate regulated services will bear unfairly the cost of billions of dollars of carriers' investment in plant and related expenses that should be instead assigned and allocated to interstate services and unregulated services.

- Numerous factors have created a gross mismatch between the current accounting of carriers' revenues and costs including, among others: the Bells' pursuit of unregulated lines of business (such as DSL and video services); the Bell's bundles (which mingle intrastate, interstate, regulated, and unregulated products); the Commission's declaration that wireline broadband services are information services; and the increase in VoIP and ISP-bound traffic that the Commission has said is interstate.

- These seismic technological, regulatory, and marketing changes warrant a close examination of costs and rates by federal and state regulators to ensure that intrastate services are not subsidizing interstate services and to ensure that regulated services are not subsidizing unregulated services.

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56 / Missoula Plan, Attachment A, "Legal Analysis of Track 1 and 2 Carriers Concerning Measures to Ensure State Compliance with Rate Provisions for Tracks 1 and 2," at 5-6.

- Delay in re-initializing excessive state rates harms consumers and therefore the Commission should issue an interim order that eliminates any residual uncertainty about states' rights to remove the costs of non-regulated and interstate activities from intrastate rates.

- Carriers' new ventures "free-ride" over a common platform, which yield excessive interstate and intrastate regulated rates.

- The Commission should reject the increase in the subscriber line charge proposed in the "Missoula Plan" unless and until a close examination of carriers' cost justifies such an increase.

- Neither existing levels of competition nor the existence of alternative forms of regulation protect consumers from today's distorted rates, which are based on outdated cost accounting rules, and carriers' failure to comply with existing rules.

- The Commission should reject BellSouth's petition for forbearance from cost allocation rules because, among other reasons, price cap regulation does not eliminate the need for cost accounting, competitive forces do not yet discipline BellSouth's regulated rates, and regulators' need for cost data outweighs any purported burden to BellSouth of providing such data.

- The Commission should eliminate ambiguity about carriers' cost accounting treatment of their unbundled network elements by aligning costs and revenues for these services.

- The Commission should issue a detailed data request in a timely manner to inform regulators' efforts to modify cost accounting rules.[57]

The Rate Counsel urges the Commission to consider the merits of the Missoula Plan, not in isolation, but rather in the context of excessive special access rates, substantial merger synergies and a universal service fund that needs reform.[58] Before the FCC

[57] / Baldwin Separations Affidavit, at 4-6.

[58] / The Rate Counsel reiterates its recommendation that the Commission discontinue non-rural high cost support for AT&T and BellSouth as a condition of any approval of the pending merger. *In the Matter of AT&T Inc. and BellSouth Corporation Applications for Transfer of Control,* WC Docket No. 06-74, Initial Comments of the New Jersey Rate Counsel, June 5, 2006, at 22.

considers allowing any increase in subscriber line charge, the Commission should first remedy the separations and special access regimes.

III. CONCLUSION

The complexities of the Missoula Plan can easily obfuscate the fundamental flaw in the proposal, namely that consumers would pay an exorbitant price in order to protect an historic and bloated revenue stream for ILECs. The Rate Counsel reiterates the recommendations it set forth in initial comments more than a year ago. At that time the Rate Counsel urged the Commission to: (1) quantify and consider the impact on any proposed change to the present systems of intercarrier compensation on consumers of basic voice grade service, particularly those with low volumes, in rural areas, and/or with low incomes; (2) reject any industry proposals that are based on a purported entitlement to an arbitrary revenue stream; and (3) defer to states on intrastate access charges and local rates because states have intrastate ratemaking authority.[59]

The Rate Counsel urges the Commission to reject the Missoula Plan because it penalizes consumers, inappropriately seeks to protect carriers from the impact of competition on their revenue stream, and would usurp states' proper roles in setting intrastate rates. The Rate Counsel also urges the Commission to consider the record in CC Docket No. 80-286 (Separations) and WC Docket No. 05-25 (Special Access) as the Commission assesses the merits of the Missoula Plan.

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[59] / Rate Counsel Initial Comments, at 13.

Respectfully submitted,

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